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No. 9707

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CARRIE GATES, CHARLES ELMER GATES and LLOYD GATES, by his guardian, Carrie Gates, *Appellants,* vs. GENERAL CASUALTY COMPANY OF AMERICA (a corporation), *Appellee.*	

REPLY BRIEF FOR APPELLANTS.

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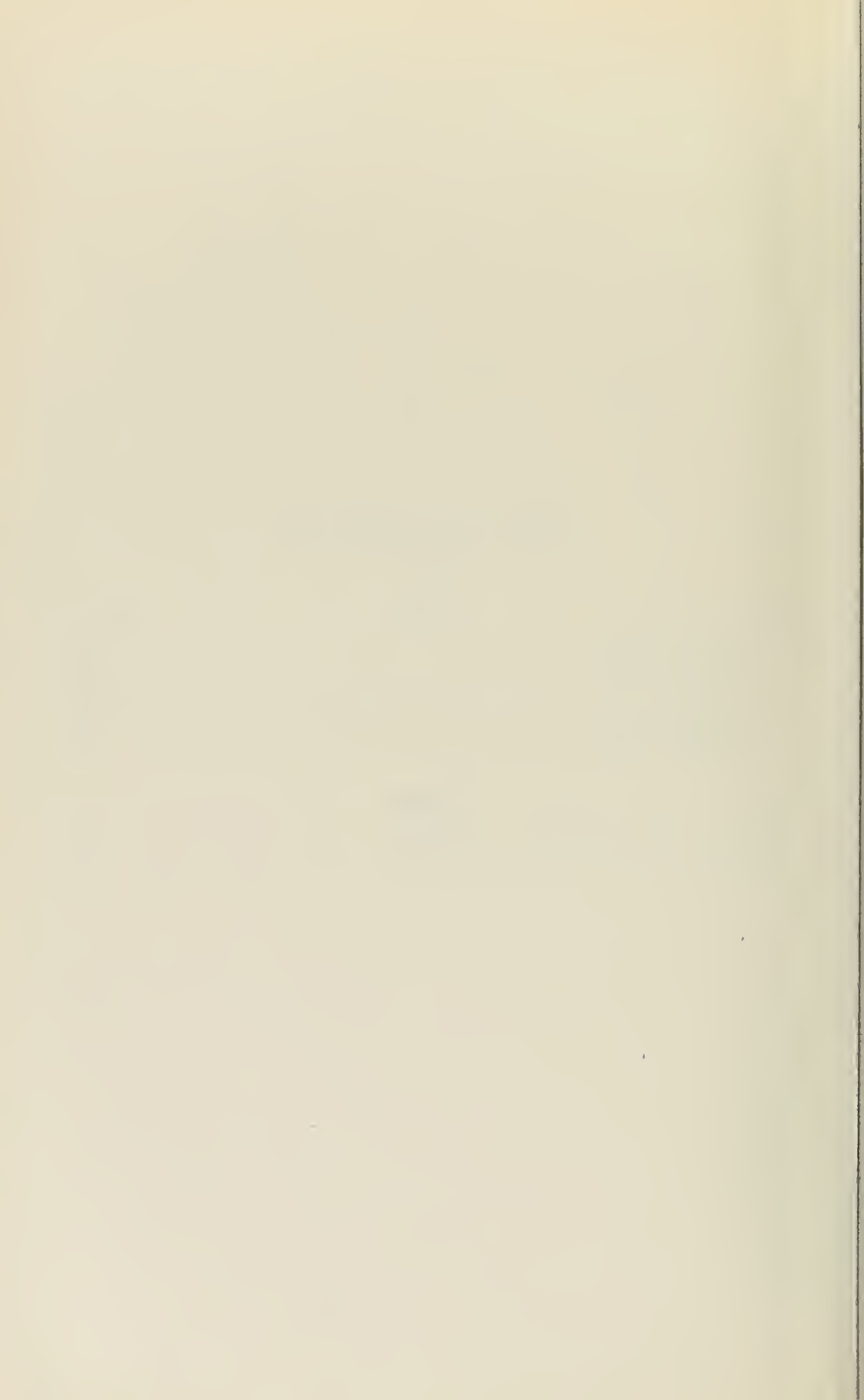

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REPLY BRIEF FOR APPELLANTS.

Examination of the brief filed by the appellee leads to the conclusion that appellee's main reliance, in the effort to escape payment of the loss involved here, is upon the fact that the insured, in the letter in which its president informed appellee that his company had been refused renewal of its insurance by another company on account of an unsatisfactory loss experience, happened to mention the fact that one of its trucks was completely destroyed in an accident upon which a loss was paid. Upon this foundation appellee constructs the theory that the policy upon which the loss was paid and the renewal of which was refused was a policy of insurance against loss by collision only,

and that since the policy being applied for was a public liability and property damage policy, appellee was justified in failing to make further inquiry as to the reason for the refusal. In order to reach that result, appellee is compelled to do much violence to the evidence. In the first place, there is undisputed evidence that the Maryland Casualty Company, the company mentioned in the letter, did not carry collision insurance, a fact which appellee, if it did not know, could have ascertained by the most casual inquiry. (R. 72, 78.) Secondly, the evidence shows that the Metropolitan Casualty Company paid property damage claims of more than $1,200.00 on a policy of the R. O. Deacon Lumber Company for an accident which occurred in the latter part of September, 1933, the time mentioned in the letter, besides other losses, which caused that company to refuse renewal of the policy, which expired November 10, 1933. Third, there is no evidence in the record of any collision loss being paid on a policy of the R. O. Deacon Lumber Company, or of that company ever having carried collision insurance. Fourth, the inquiry to wihch Mr. Deacon was replying was specifically limited to public liability and property damage claims and it is to be assumed, in the absence of some definite statement by him to the contrary, that that was the type of insurance to which he referred. Fifth, Mr. Deacon did not say in his letter that the payment which was made on account of the accident which he mentioned was for the loss of his truck. What he said was, "Our insurance was then carried by the Maryland Casualty and this loss cost them too much and they withdrew

the coverage shortly after that time". Sixth, Mr. Haney did not testify that in writing public liability and property damage insurance the company was only interested in the experience of former carriers of that type of insurance, and that hence no inquiry was made respecting collision insurance. The portion of the record referred to by appellee in support of that assertion reads as follows: "We checked with the Maryland to see that the experience with them was correct. * * * That was all we were interested in because we were only writing public liability and property damage." (R. 46.) When testifying specifically on the matter of materiality Mr. Haney said, "Frequency of accidents bears more importance in considering the acceptability of a risk of this nature than any other consideration". (R. 44.)

The real question is not whether the interpretation of Mr. Deacon's letter now adopted by appellee for the purpose of avoiding payment of a loss is a possible interpretation, but whether or not it is an interpretation which would have been adopted and acted upon by a prudent underwriter of insurance in the situation of appellee at the time of issuing the policy. As between two permissible interpretations of an answer made by an applicant for insurance to an inquiry, it is obviously the part of prudence to adopt the one which suggests the need of further inquiry rather than the one which does not. To make further inquiry is the safe course, while failure to do so involves an entirely unnecessary risk. To adopt one interpretation for the purpose of issuing the policy and getting the premium, with the intention

of charging the applicant with fraud in case the other interpretation turns out to be correct after a loss has occurred, is obviously bad faith.

There is no warrant for the conclusion that collision losses were immaterial. The accidents upon which public liability and property damage claims are paid are the same accidents as those upon which collision losses are paid. When an automobile owner has an accident, the company carrying the collision insurance repairs his car and the company carrying the public liability and property damage insurance pays the necessary compensation to the other parties to the collision. The record of either company would reflect the frequency of accidents and would furnish the information necessary to enable another company to determine the acceptability of the risk for either kind of insurance. Although there might be accidents in which a car inflicts injury without being itself damaged, and other accidents in which a car is damaged without any claims being made by other persons as a result of the accident, nevertheless, the frequency of accidents involving both types of losses depends upon the same psychological and mechanical factors, and, according to the law of averages upon which insurance companies operate, a definite relation between the two kinds of loss may be expected in the case of a given owner. This is a matter of common knowledge, of which the court takes judicial notice, and the mere fact that one insurance underwriter chooses to ignore obvious facts would not, if it were established, constitute evidence of the immateriality of collision losses in considering an application for liability insurance.

Another contention relied upon by appellee is that after the broker received the letter from Mr. Deacon, which he handed to appellee, he told appellee that the Maryland and Madison had been the only carriers on the line for several years previous. That is not an accurate statement of the evidence and conveys the false impression that Mr. Drenth, after giving Mr. Deacon's letter to appellee's agents, made independent statements which justified them in disregarding the one contained in the letter. There is no evidence that Mr. Drenth ever made the statement that the Maryland and the Madison had been the only carriers on the line for several years previous. The testimony cited by appellee in support of that assertion is the direct examination of Mr. Sturges. (R. 27.) He testified that he had two conversations with Mr. Drenth. Regarding the first he said, "I asked him for the names of the previous carriers and he advised me that he would secure that information, but, as he recalled, it was the Maryland Casualty Company and the Madison in Chicago, the latter company having just retired from this state". Regarding the second conversation he testified as follows: "He later advised me that he had this information and that the Maryland Casualty Company had had a satisfactory record, the total claim payments being something like $58.00, and that the Madison Insurance Company had had only some trivial claims not involving any personal injuries, and no accident frequency beyond the normal expectancy. He mentioned no other insurance carrier at that time, claiming that the two companies covered the period of several years previous." The

letter was not called to his attention on direct examination, but, on cross-examination, after it had been read to him, he testified as follows: "I didn't have any conversation with Mr. Drenth in reference to the subject matter of this letter that you have just read. The letter was in the office. He delivered the letter to the office and I read it afterwards but not while he was there. I did not personally, after reading the letter, call Mr. Drenth and discuss it with him." (R. 34.) When asked to state the substance of the second conversation with Mr. Drenth, he testified as follows: "Well, he stated that he had secured the information from the Deacon Lumber Company, had submitted it to our office and he stated that the Maryland Casualty Company had one claim and small claims in the Madison, that is all I recall was discussed." (R. 37.) Mr. Haney testified as follows: "The second conversation brought out that the Maryland Casualty Company had been on the line and they, as far as their experience, they had had a small amount of losses somewhere around $50.00, $53.00 in property damage, no public liability losses; they had had their insurance for a short time in the Madison. * * * In my conversation with Mr. Drenth I asked him for the names of the insurance carriers of the R. O. Deacon Lumber Company. The names given were Maryland Casualty Company and the Madison." (R. 44.) On cross-examination he testified: "I had another conversation with Mr. Drenth which took place in the early part of June, around the first couple of days in June. At that time Mr. Drenth came in with a list of the equipment and with the information

that the Maryland Casualty Company and the Madison had been on the line." (R. 45.) Mr. Haney testified that he never saw Mr. Deacon's letter. The testimony of Mr. Drenth was to the effect that he did not make any oral representations concerning the risk, but gave the company's representatives Plaintiff's Exhibit #2 and a letter from Mr. Deacon, which listed the numbers of the trucks and the models and areas in which they were used. (R. 56, 60.)

It is also contended that Mr. Sturges and Mr. Haney made definite inquiries as to the names of the insurers and the number of losses for a period of three or four years previous to the application. There was some evidence which might have justified the court in making such a finding, but the court did not so find. The letter in which Mr. Drenth passed the inquiry on to Mr. Deacon corresponded substantially to the inquiry made by appellee as found by the court, and that was the inquiry to which Mr. Deacon was replying.

Appellee contends that the failure to prove intent to deceive is immaterial, invoking the rule that a false representation or concealment of fact, whether intentional or unintentional, which is material to the risk, vitiates the policy without the presence of an intent to deceive. Appellee did not plead and the court did not find that there was any unintentional misrepresentation or concealment material to the risk. Pleading and finding both sound in fraud and an essential element of fraud is the intent to deceive. The court did not find what facts, if any, were misrepresented, so we cannot determine whether or not

they were material to the risk. The only misrepresentation shown by the evidence is that of the name of the company which refused to renew the insurance. "Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries." (Insurance Code, Section 334.) Although concealment of the name of a previous insurer might have a probable and reasonable influence upon the prospective insurer in making his inquiries, mere misstatement of the name of the insurer could hardly be expected to hinder an inquiry, since the error must of necessity be promptly discovered when the information is used for that purpose. In the present case it so happened that the company named had actually carried the insurance, but not at the time mentioned, and the other information given in connection with the erroneous statement of the name made discovery of the mistake inevitable if inquiry were made. Failure to mention the other losses paid by the same company could not be reasonably expected to influence appellee in forming its estimate of the disadvantages of the proposed contract, when it was informed that the loss was too much and that the company which paid it withdrew the coverage shortly thereafter. Appellee could reasonably be expected to assume that there was adequate reason for the withdrawal and there was nothing to indicate that the loss mentioned was the only one. The applicant also knew that if appellee was interested in the

details of the experience which caused the other company to take such action, it could easily obtain them by further inquiry. It is not the actual influence of the omission upon the insurer which determines materiality but the influence which the applicant might reasonably have anticipated. The evidence not only fails to support the finding of fraud, but it would to the same extent have failed to support the finding of misrepresentation or concealment of material facts if such findings had been made.

Appellee relies upon Section 330 and 332 of the Insurance Code, but the proof fails to bring the case within the provisions of those sections. According to Section 330 an essential element of concealment is the duty to communicate, resting on the party who fails to communicate that which he knows. Defendant failed to establish any duty resting upon Mr. Deacon to communicate to defendant any fact in addition to the one fact which he did communicate, namely, that the company in which he was insured had paid a loss which cost too much and had refused to continue the insurance. That was an ultimate fact which fairly included within its scope all of the subsidiary facts constituting the reasons for the refusal. Under the provisions of Section 332 of the Insurance Code, he was required to communicate to defendant, in good faith, all facts which were or which he believed to be material to the contract, and which defendant had not the means of ascertaining. Communication of the fact that insurance had been refused by another company put appellee on notice that there were reasons for the refusal and appellee had the means of ascer-

taining what those reasons were. Appellee has preferred not to call the attention of this court to Section 336 of the Insurance Code, which provides that "The right to information of material facts may be waived * * * by neglect to make inquiries as to such facts, when they are distinctly implied in other facts of which information is communicated". The fact of a previous refusal of insurance distinctly implies that there were reasons for the refusal and, if the insurance company fails to make inquiries as to the reasons, the right to be informed as to further details of the facts constituting such reasons is waived.

Appellee falls back upon the rule that there is no primary duty to investigate and verify statements, to the truth of which the other party has deliberately pledged his faith, but the record fails to disclose any false and material statement to which the R. O. Deacon Lumber Company deliberately pledged its faith. The rule applies only to positive representations of fact and not to alleged concealment in reference to insurance. The provisions of the code limit the duty of the applicant for insurance to communicating to the insurer those facts which the insurer has not the means of ascertaining. (Insurance Code, Section 332.) All of the cases cited in appellants' opening brief are cases of concealment, and declare the law applicable thereto. The cases cited by appellee are cases of positive representation, and the principle by which they are governed is not applicable here. A party to a contract has a right to rely upon a positive representation of a material fact made by the other party, although he has the means of knowledge at

hand, but one party cannot charge the other with concealment of material facts if he has notice of circumstances sufficient to put a prudent man upon inquiry which, if pursued with reasonable diligence, would result in the discovery of the facts alleged to have been concealed.

It may be conceded that whether one has notice of circumstances sufficient to put a prudent man on inquiry is a question of fact, but it does not follow that this court cannot correct a plain error of the trial court in its determination of that fact. If there is room for a reasonable difference of opinion as to whether the circumstances are sufficient to put a prudent man upon inquiry, the decision of the trial court is final, but if their sufficiency is so clear that there is no reasonable ground for dispute, this court must declare them sufficient as a matter of law.

We find appellee's position concisely stated at page 26 of its brief. Counsel begin by stating our argument to be based upon the contention that appellee was negligent in not investigating and probing the facts until the truth was revealed. The doctrine on which we rely is not founded on the theory of negligence, but its basis is an assumption of bad faith. In our opening brief we quoted an authoritative statement of the doctrine from Ruling Case Law. (Vol. 20, p. 346.) It is there said that want of knowledge in such cases is a species of fraud, and that when one has actual knowledge of such facts as would put a prudent man on inquiry, it becomes his duty to make inquiry, and he is guilty of bad faith if he

neglects to do so. Although in this case it is possible that no individual agent of the corporate defendant was guilty of anything worse than negligence, the law can do nothing else than impute bad faith to the corporation as a legal entity. If, on the other hand, we are to accept the theory that Mr. Sturges relied upon the statements of the broker, rather than upon Mr. Haney's recommendation, in issuing the policy, he was guilty of bad faith in relying upon such statements without an investigation of the statements made by Mr. Deacon in his letter. Appellee contends that it was informed by the broker that only the Maryland Casualty Company and the Madison Insurance Company had been the carriers of the R. O. Deacon Lumber Company's insurance for several years previous, and that this was a positive representation of fact upon which appellee was entitled to rely. Mr. Drenth's statement was not made in that positive and definite form. The testimony of Mr. Sturges was that the broker claimed that the two companies covered the period of several years previous. That testimony was given before the letter was called to his attention and, on cross-examination after the letter was read to him, he contradicted it. His corrected testimony was that Mr. Drenth told him that he had secured the information from the Deacon Lumber Company and had submitted it to appellee's office, and that he stated that the Maryland Casualty Company had one claim, and that there were some small claims in the Madison. The witness stated that he did not recall that anything further was discussed. Apparently he did not mean to testify

that the broker said the two companies had been the only insurers for several consecutive years immediately preceding the application, but, assuming that he did, this statement was coupled with a statement of the losses suffered by the two companies which showed that if they were the only two insurers, the statements contained in Mr. Deacon's letter could not be true. The statement of the broker as a whole was contradicted by the written statement of the principal. Consequently, it could not be considered as a positive statement of fact to which the principal had deliberately pledged his faith, even though it was within the general scope of the agent's authority to make it, and would have bound the principal if it had stood alone. Appellee undertook an independent investigation and asked the Maryland Casualty Company for the total amount of claims paid by it, but did not inquire as to the period of time covered by the insurance, although it well knew that such an inquiry would be necessary to a settlement of the conflict between the statements of the broker and those of the principal. Mr. Deacon's letter was not cryptic, and its meaning would have been evident to any reasonable man in the situation of appellee. After appellee found that the statements were erroneous, there was no justification for assuming that the error consisted in the fact of insurance having been withdrawn, and not in the name of the company which carried the insurance at the time. It might have been either, and error in the name of the company would have suggested itself to a reasonable man as being much more likely to occur. At any rate it

was the safer lead to follow, and any prudent person would have followed it. It seems hardly necessary to say that if Mr. Deacon's attention had been called to the mistake, he would have informed appellee that it was the Metropolitan Casualty Company which withdrew the coverage, and inquiry from that company would have revealed all of the facts, just as it did after the loss had occurred.

The statement over the signature of its own president that the R. O. Deacon Lumber Company's insurance had been cancelled by another company after a heavy loss was a red flag posted beside the track as a warning signal of danger, and if the engineer chose to disregard the warning, the passengers are entitled to hold the railroad company responsible for the consequences. In that case, it would make no difference who told him that the signal had been posted as a Halloween prank. Anyone who takes the responsibility of ordering the train to proceed must know why the red flag was there.

The final contention is that appellee would be entitled to prevail upon the defense of fraud, even if it were not entitled to rescind. Our specification of errors is drawn so as to conform to the findings and conclusions of law which were framed upon the theory of rescission. The argument which we have presented, however, is equally applicable to rescission and to fraud as an affirmative defense, without rescission. We have not attacked the findings and conclusion with respect to rescission upon any ground which would not have been applicable to the simple find-

ings of fraud and concealment. Our argument upon the point that the rescission was not in time is in reality directed to the point that the right of rescission never existed.

Appellee complains that our specification of errors in our opening brief and our designation of points for the purpose of printing the record are not the same. A comparison of the two will show that they cover the same ground, although they are not identical in form. The designation of points may be general, and if it enables appellee to determine what papers he should ask to have included in the printed transcript, it is sufficient. Greater particularity is required in the specification of errors. In drafting the specification of errors we had to deal with the findings and conclusions of law as they were written, and, to the best of our ability under the circumstances, we endeavored to make our points clear to the court and opposing counsel.

We submit that the judgment is contrary to the evidence and should be reversed.

Dated, Fresno, California,
April 9, 1941.

Respectfully submitted,

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